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No. 328

In the Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ALABAMA ASPHALTIC LIMESTONE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 33–54) is published at 41 B. T. A. 324. The opinion of the Circuit Court of Appeals (R. 154–157) is reported in 119 F. (2d) 819.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 5, 1941 (R. 157). The petition for a writ of certiorari was filed July 31, 1941, and was granted on October 13, 1941. The jurisdiction of this Court rests on Section 240 (a) of the Judicial code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Pursuant to plan, corporate assets were bought in by a creditors' committee at bankruptcy sale. The property was transferred to the taxpayer, a new corporation, which issued its preferred and common stock to participating creditors. The question is whether the basis of the assets for purposes of computing depreciation and depletion is the same as it would be in the hands of the old corporation under Section 113 (a) (7) of the Revenue Act of 1932.[1] The answer depends upon whether the transaction constituted a "reorganization" within the definition of Section 112 (i) (1) of the Revenue Act of 1928.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 8–10.

STATEMENT

Alabama Rock Asphalt, Inc., the taxpayer's predecessor corporation (hereafter referred to as Alabama) was a wholly owned subsidiary of the Deep Water Coal & Iron Corporation. In 1929–1930 it had outstanding various unsecured notes, issued in return for advances made by individual stockholders of the parent corporation. These notes were to mature February 1, 1930, with the

[1] This section, made applicable by Section 113 (a) (12) of the Revenue Act of 1932, is the same as Section 113 (a) (7) of the Revenue Act of 1934.

exception of one which was to mature April 14, 1929[2] (R. 34–35).

Following a failure to obtain the agreement of all noteholders to take stock in the company at the maturity of their claims, a creditors' committee was formed later in 1929, and a plan was proposed to which all except two of the creditors assented. The plan provided for the formation of a new corporation which would acquire Alabama's assets. The stock of the new corporation, consisting of preferred and common stock, would be issued to the old creditors (R. 35–36).

With the assent of the creditors, except for the two dissenters, involuntary proceedings in bankruptcy were instituted on September 11, 1930, and a trustee appointed. The appraised value of the bankrupt's assets was $155,876.52 (R. 36); as of December 31, 1930, its liabilities, consisting of the notes and sundry other obligations, aggregated $838,690.51 (R. 37).

The trustee in bankruptcy offered the assets for sale at public auction on January 8, 1931, and they were bought in by the committee for $150,000 (R. 37). It appears from the trustee's report that the committee deposited $15,000 in cash, offered to deliver in part payment the agreement of the creditors to take stock of the new company in satisfaction of their claims, and also offered to

[2] The latter note was endorsed by the parent corporation and secured by all the stock of Alabama (R. 35).

pay in cash any balance necessary to meet costs of administration, etc., and a dividend to non-assenting creditors (R. 37).

Thereafter, the taxpayer was formed and acquired the bankrupt's assets. In accordance with the plan, its stock was issued to the assenting creditors, representing approximately 92% of the total claims (R. 37–38).

In computing its depreciation and depletion allowances for the year 1934, the taxpayer treated its assets as having the same basis that they had in the hands of the old corporation. The Commissioner, in determining the deficiency, used as the basis the cost of the assets to the committee, taking as representing the cost, the price paid at the bankruptcy sale. The Board of Tax Appeals rejected the Commissioner's position, and the court below affirmed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the taxpayer's assets had been acquired in connection with a "reorganization" of Alabama and that, therefore, the basis was the same as it would be in the hands of that company.

(2) In failing to hold that the basis of the assets was the cost to the creditors' committee at the bankruptcy sale.

(3) In sustaining the decision of the Board of Tax Appeals.

ARGUMENT

Although this case involves a readjustment effected through bankruptcy, rather than through a receivership proceeding, and the immediate issue is the basis for computing depreciation and depletion, rather than gain or loss, the fundamental problem before the Court is the same as that dealt with in *Commissioner* v. *Southwest Consolidated Corporation*, No. 286, present Term. The Government's position has been fully developed in its brief, filed in that proceeding, to which the Court is respectfully referred.

The Court's attention, however, may appropriately be directed to two points of difference between the two cases, although neither, we submit, warrants a different disposition of the cases:

(1) In the *Southwest Consolidated* case, stock purchase warrants were issued in exchange for stock of the old corporation. Here the former stockholders received nothing at all. This fact would, if anything, strengthen the Government's position in the instant case. In accordance with the views expressed in our *Southwest Consolidated* brief, however, we do not believe the presence or absence of such warrants should affect the determination of the issue involved.

(2) The instant case involves the application of the reorganization definition contained in Section 112 (i) (1) of the Revenue Act of 1928, rather than the definition in Section 112 (g) (1) of the Revenue Act of 1934. Clause A of the

earlier definition referred to "a merger or consolidation (including the acquisition by one corporation * * * of substantially all the properties of another corporation) * * *." The 1934 Act subdivided Clause A into Clauses A and B, reading as follows:

> * * *. (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock * * * of substantially all the properties of another corporation. * * *

Thus, the parenthetical part of former Clause A was replaced by the new Clause B, and the requirement was added that the property must be acquired "in exchange solely for all or a part" of the transferee's "voting stock."

This difference in the language of the relevant statutory provisions may lead to a different conclusion in considering the application to this transaction of the literal language of the statutory definition. If the transaction, following the analysis we have employed in the *Southwest Consolidated* brief, is treated as involving two steps—i. e., (1) the purchase by the committee and (2) the committee's transfer to the new corporation—the transaction still would not come within the language of the Act for the reasons we have there developed. If, on the other hand, the transaction is regarded as involving but one step—i. e., the acquisition by the taxpayer of the assets of the old

corporation in return for a distribution of its preferred and common shares to nonassenting creditors plus a cash payment for dissenters and other expenses—the parenthetical part of Clause A in the 1928 Act, in contrast to Clause B in the 1934 statute, would literally apply.

This conclusion, however, would not alter the ultimate results. The controlling fact is that irrespective of the application of the literal language of the statute, the absence of a continuity in the new corporation of the proprietary interest in the old takes the case beyond its purview. *LeTulle* v. *Scofield*, 308 U. S. 415.

As in the *Southwest Consolidated* case, the Commissioner now takes the position that the new basis should be measured by the market value of the assets rather than the bid price. Government's brief, fn. 5. If the Court agrees that there is no reorganization, further proceedings before the Board of Tax Appeals would be appropriate to determine that market value and to recompute the deficiency accordingly.

Respectfully submitted.

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DECEMBER 1941.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), * * *

* * * * * *

(j) *Definition of control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * * *

(7) *Transfers to Corporation where control of property remains in same persons.*—If the property was acquired after Decem-

ber 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(12) *Basis established by Revenue Act of 1932.*—If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purposes of the Revenue Act of 1932 was prescribed by section 113 (a) (6), (7), or (9) of such Act, then for the purposes of this Act the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined

under subsection (a), adjusted as hereinafter provided.

* * * * *

(U. S. C., Title 26, Sec. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

(b) *Basis for Depletion.*—

(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * *

(U. S. C., Title 26, Sec. 114.)

The relevant provisions of Regulations 86 under the Revenue Act of 1934 are set forth in the Appendix to our brief in the *Southwest Consolidated* case. Regulations 77 under the Revenue Act of 1932 and Regulations 74 under the Revenue Act of 1928 do not contain provisions material to the question in issue.

Regulations 74, Article 193, corresponds to Regulations 86, Article 23 (k)–3 referred to in Fn. 5 on page 13 of that brief.

U. S. GOVERNMENT PRINTING OFFICE: 1941